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# CHAPTER V .

## PUBLIC REVENUE - INCIDENCE AND EFFECTS OF TAXATION

I. Shifting and Incidence of Taxes

II. Special Taxes and their Incidence

III. Economic Effects of Taxation

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## 1. Shifting and Incidence of Taxation :-

A tax { (a). may be imposed on same person
(b). " " transferred by him to a second person who bears the burden
(c). " " borne by the second person or transferred to others by him gradually }

Thus the man who is originally taxed may not bear the burden in the last instance. The process of the transfer is known as the shifting of the tax. Transference may be in different directions — Producer to consumer or from consumer to producer as buyer & the seller.

On whom does the tax ultimately fall — who it is paid by finally — & why & how the tax is shifted — That is the problem of incidence

In some taxes the chances of shifting are very small. eg. monopolies — ~~Taxation to be borne at of monopolists profits~~. economic rent, pure profits, net income etc.

There are other taxes where the taxes are shifted in their entirety; taxes on commodities, import duties, excise taxes, etc

In case of a tax have backwards, forwards & diffused shifting.

Difficulties to be overcome by the person bearing impact of tax & who wants to shift it.

Obstacles to shifting a tax if
(1) If chance to change from one occupation to another, if his capital is movable.
(2). If there is not elasticity of demand for commodity taxed — Agriculture
(3). ~~If the production~~ A tax on land may be objected to

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### I. Shifting and Incidence of Taxes:-

In the process of taxing we must distinguish three conceptions. First a tax may be imposed on some person; secondly it may be transferred by him to a second person; thirdly it may be ultimately borne by this second person or transferred to others by whom it is finally assumed. Thus the person who originally pays the tax may not be the one who bears its burden in the last instance. The process of the transfer of a tax is known as the shifting of the tax, while the settlement of the burden on the ultimate taxpayer is called the incidence of the tax. The incidence of the tax is therefore the result of the shifting. The course of transference may be in different directions - The movement may be from the producer to the consumer and from the seller to the buyer or it may be from the consumer to the producer and from the buyer to the seller.

We must not compound the incidence with that effect of taxation. A tax may have great many effects: it may diminish or stimulate production; it may impoverish or enrich individuals; it may be a curse or a boon to the community. With some of these problems does incidence concern

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itself. On whom does the tax ultimately fall, by whom is the tax finally paid, whither, why and how is a tax shifted - that is the problem of incidence. Says Adams, "by the incidence of the tax is meant the final resting place of its payment. By the shifting of the tax is meant the process according to which he who makes payment imposes what he has paid upon someone else". For example the incidence of a tax on sugar collected from the seller is wholly on the buyer, if, as a direct result of the tax, the prices rises by at least the full amount of the tax; wholly on the seller, if the prices does not rise at all; partly on the buyer and partly on the seller, if the prices rises by an amount less than the full amount of the tax.

There are some taxes where the chances of shifting are very slight: e.g., taxes on monopolies, taxes on economic rent, taxes on pure profit, taxes on net income, taxes on inheritance. There are some taxes which will be shifted in their entirety: e.g. taxes on commodities, import duties, excise taxes, taxes on gross receipts of companies.

The incidence of a tax may move in various directions; we may have forward, backward and diffused shifting. A commodity moves from producer to consumer and somewhere between the two stands the tax-gatherer. If the tax is incident upon anyone between the tax-gatherer and the producer, we have a case of backward shifting; if it is incident upon a person between the tax-gatherer and the con-

consumer, then we have forward shifting, whilst if the tax spreads itself through the community in all directions, then we have diffused shifting.

The difficulties which have to be overcome by the person bearing the impact of a tax in attempting to shift it are -

(1) He has a greater opportunity of recovering the tax if he can change from one occupation to another, that is, if his capital is mobile.

(2) If he cannot easily move from one business to another, then he may not be able to obtain payment of the tax. A further obstacle to his transfer of the tax is a great elasticity in the demand for the commodity taxed. A demand is said to be elastic when a slight change of the price makes a great change in the amount purchased.

If the tax on coffee is raised, it may not be easy for a dealer to transfer the tax to the consumer because by so doing he will raise the price, and probably curtail the demand. In the case of a commodity, the demand for which is elastic, a sudden increase of the tax will probably fall upon the merchant himself. He will not be able to shift the tax to the consumer by an increase in price because if he attempts to do so the demand will fall.

(3) If an article is produced under conditions of monopoly, it may be impossible to shift the tax. A monopolist sells his commodity at a price which yields him the maximum net return. If, therefore, he adds the amount of the tax to his selling price, it will be increased to a level which will yield a smaller return. In these circumstances, it will be to the interest of the monopolist to pay the tax himself.

(4) The manner in which the tax is imposed may also give rise to difficulties. A tax of one shilling on a barrel of beer, collected from the brewers, would be a difficult tax for the brewers to pass on to the consumer, because a barrel contains thirty-six gallons, and they cannot recover the amount of the tax by adding a small amount to each glass of beer sold. If ½ d. were to be added to the cost of each glass of beer there would be a great outcry amongst consumers, since the brewer would be recovering far more than the amount of the tax. The tendency is for the brewer to recoup himself by lowering the quality of the beer. If this is prevented by the force of competition, then the tendency will be for the tax to remain where it originally falls.

## II. Special Taxes and Their Incidence:-

We have briefly reviewed the general principles of the incidence and effects of taxation; we shall now examine the characteristics of a few of the most important taxes.

1. Land Tax:-

Taxes on land appear to be in almost universal use, and are found at all periods of history. The general tendency is for such taxes to fall on the owner of the land. It is true that, if the land is leased to a tenant, the owner would be willing to attempt to shift the tax by charging a higher rent for the land. If, however, the owner is already receiving the full economic rent of the land, then the tenant will be unable to pay more and still make cultivation worth while. It is only if an amount less than the true economic rent is being charged that a land tax will be shifted. Again, as between the present owner and a future purchaser of a piece of land, there is a tendency for the tax to be borne by the former, since the tax will tend to be absorbed in the lower capital value which the land will yield after the imposition of the tax. In other words, the tax burden will be discounted by the new owner by his offering a lower price for the land, always provided that there are open to him other types of investment less heavily taxed.

2. Income Tax:-

Despite many arguments to the contrary, it would appear to be fairly certain that the burden of the income tax tends to stay where it is levied. It has been argued that traders try to shift the tax on to consumers by adding it to the prices of the commodities which they sell. Yet, as

uniform as between the testator and those who benefit under his will. If, for example, the testator deliberately curtails his expenditure during his lifetime with a view to making provision for the taxation which he knows will fall upon his estate after his death, then undoubtedly the incidence of the tax is upon him. If the testator makes no such provision, then the full incidence of the tax is upon the successor. The matter cannot easily be settled, for, as the Colwyn Committee on National Debt and Taxation has said -

> In favour of the view that the duty is on the successor it may be pointed out that it is not paid by the predecessor, that there is no liability till he dies, and that he is free to ignore the duty if he wishes, while the successor, as a hard matter of fact, comes into so much less than he would have done, and has no kind of redress.
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> On the other side it may be answered that the subject of taxation is, after all, the property which has been held or accumulated by the deceased, and that the tax has fallen upon him, in the sense that it has affected the amount of which he could dispose.

4. Stamp Duties:-

These taxes do not constitute a scientific type of taxation, since their incidence is by no means clear, they have no particular relation to ability to pay, and they tend

Professor Pigou told the Committee on National Debt and Taxation, the tax "is assessed on the profits resulting from trade and industry, and if, as may be presumed, people are already charging the prices that yield them the best profit, the removal by the State of a portion of the profit will not tempt them to fix prices differently". Should the income tax cut too deeply into the return considered necessary to maintain the conventional standard of living, then the individual may attempt to shift it by seeking an advance in salary. This is scarcely likely to be successful, however, unless the individual happens to be in an especially favourable position. In the case of a limited company, there is much less motive for any attempt to shift the tax. A company, in making a distribution of profits, recoups itself by a deduction of tax from its shareholders, and is not in the least interested in the fluctuation of their individual liability. Hence, to this extent, the rate of tax is a matter of indifference to the company, and in consequence it has but little inducement to raise its prices on account of an increase in the rate of tax.

3. Estate Duty or Death Duty or Inheritance Tax:-

Many controversies have arisen over this tax and its effects. It is usually considered that the tax is levied on the transfer of property, rather than on the property that is transferred. The incidence of the death duties is not

to hamper business transactions.

5. Excise Duties:-

The excise duties are indirect taxes which are intended to be, and are, passed on to the consumer. The taxes on alcoholic beverages, which form an important part of the British excise duties, have pressed heavily upon the working classes in the post-war period and not on the producers of the beverages.

III. Economic Effects of Taxation:-

Since all taxation must be met out of the national dividend - the aggregate of values produced by the industry and commerce of a country - it is evident that nothing should be done by way of taxation which is likely to impair the productive efficiency of the nation. Taxation, from the standpoint of the business community, is always regarded in the light of a burden, largely because there is no direct connection between the amount contributed in taxation and the services received by the individual.

A question which is frequently raised is the effect which direct taxation exercises on the incentive to work. The report of the Colwyn Committee on National Debt and Taxation comments on the conflicting evidence of witnesses on this point. There are those who maintain that excessive taxation

destroys the incentive to work, whilst others contend that it serves as a stimulus to those who wish to avoid an unwelcome reduction in their standard of living. In this connection, however, it was pointed out that "the great mass of the national output of productive work comes from those whose incomes and property are either wholly, or almost wholly, below the level at which liability to direct taxation begins". Again, it is frequently alleged that heavy taxation discourages enterprise and initiative, in that it claims a substantial part of any profits which may be made, but does not allow losses incurred to be set off against them. From this it is argued that the general effect is to cause business men to prefer well-established and relatively safe enterprises to new and relatively risky ones, and that new developments will tend to languish.

Again, when the burden of taxation is excessive, the net sums which business enterprises can place to reserve are reduced, since profits not distributed to shareholders are subject to income tax. The reserves which business enterprises thus accumulate form an extremely important addition to national capital. Capital accumulated by way of business reserves is created in the place where it is required - "it is at the growing-point of industry, enabling new needs and opportunities to be met without delay as and when they arise. This is true of the new enterprising business, which may as

yet be making only small profits, as well as of the established company whose ability to save large sums for development year by year has given proof of efficiency and power of continued expansion". In so far as high taxation restricts the sums available for these purposes, it is detrimental to the soundness and prosperity of industry and trade.

Taxation may affect production by restricting the general volume of savings apart from company reserves. This result may be brought about both by diminishing the power to save and by undermining the will to save. The greatest effects on the capacity to save will tend to fall on the wealthier classes, from whom the bulk of the saving comes under the present system of the distribution of wealth.

Summing up, we may infer from this very brief examination that the effects of taxation upon production are difficult to assess, and that easy generalizations, which are only too frequently made, can be extremely misleading. As Dr. Dalton points out in Public Finance -

If all the proceeds of taxation were spent on waste, which contributed nothing to economic welfare, then any check to production as a result of taxation would be a clear economic loss. But if the proceeds of taxation are wisely spent, the stimulus to production due to this expenditure may be far stronger than the check to production due to taxation. Public finance, viewed as a whole, would then be

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responsible for increasing production.

There are many who maintain that a system of taxation should go beyond the mere raising of revenue, but should be employed as an instrument in the hands of governments for redressing the inequalities which exist between different sections of the community, or to achieve any other object of social control which is deemed to be desirable in public interest. Thus, heavy income tax and sur-tax may be deliberately imposed to bring about a redistribution of wealth among different sections of the community. The incomes of the well-to-do are diminished, whilst those of the poorer classes are augmented, either directly by pensions and grants, or indirectly by the free provision of social services.

Possibly the most striking method of employing taxation to redress social inequality is in the case of death duties. The inequality of wealth and income is one of the most serious aspects of the system of private property, and there are many who consider that such inequalities might well be reduced by a wider application of steeply-graduated taxes on accumulated wealth. As Professor Clay points out, the inequality which arises from inheritance must be distinguished from that resulting from differences in the natural capacity of the individual.

In this connection, too, we may note the various attempts which have been made at the taxation of a surplus, that is, of that portion of income or of capital value which is not the result of any useful economic effort on the part of the recipient. Thus, in the United States, property in the neighbourhood of cities is subject to betterment charges. A share of the surplus value in the land which follows from such a circumstance as the development of a large city is appropriated by the State through taxation. Obviously the property owner has done little, if anything, to create this extra value, so that it is only equitable that he should be made to give up part of the value which the community has created for itself. Even here the subject presents great practical difficulties, such as the valuation of a fair return to the capital which the owner has actually invested in the property.

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